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SPECTRUM SIGNAL PROCESSING
annual report

1996





annual report

company profile

Spectrum Signal Processing Inc. is the market leader in Digital Signal Processing (DSP) systems. The Company provides many competitive advantages to its OEM customers by offering industry standard products, leading edge technology and fast time-to-market. Spectrum develops and manufactures products for every element of a DSP system from application software and operating systems to custom integrated circuits and plug-in boards for standard computer platforms.

Spectrum's primary vertical markets include fast growing segments such as remote sensing, medical equipment, instrumentation, motor control, and high-density modems. The Company has an outstanding track record in the DSP industry for providing quality solutions coupled with superior customer service which has attracted long-term Fortune 1000 customers and partners including IBM, Nortel, Hewlett-Packard, Siemens and NEC.

Spectrum has grown its revenue an average of 41% annually since 1991. Its staff numbers over 150, with almost half the Company directly involved in engineering and product development. The Company's corporate headquarters are located in Burnaby, British Columbia. Spectrum also supports four field offices in the United States and 18 manufacturers representative firms and distributors around the world.

Spectrum is traded on the NASDAQ NMS under the symbol SSPIF and on the Toronto Stock Exchange under the symbol SSY. Spectrum can be found on the world wide web at: <http://www.spectrumsignal.com>.

financial highlights

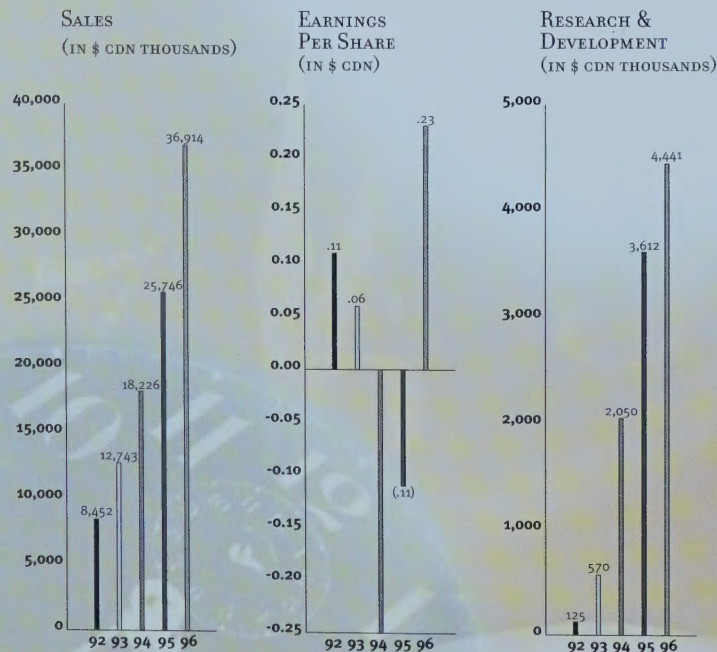


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Y E A R

letter to shareholders

Spectrum Signal Processing is committed to enabling our customers, which is precious to our customers who need to process information in billionths of a second, success through the competitive advantages provided by our products.

We provide unique DSP system solutions from project concept to completion, including standard and custom OEM products, development tools and application consulting. We achieve our goals by

understanding the needs of our customers, providing quality products and services and building strategic relationships with the key players in our chosen markets.



Technology and high-quality manufacturing capabilities continued to attract Fortune 1000 product development partners and customers in 1996. For example, together with Hewlett-Packard we developed DSP products for VMI systems, which will be co-branded and sold by both companies. These products, consisting of DSP boards and software, are targeted at test and measurement, communications, industrial inspection, cellular base stations, diagnostic imaging, military, and aerospace applications which require significant signal processing horsepower.

Spectrum's Computer Telephony business also progressed during the year. Highlights include a development agreement for modern circuitry and DSP software with a major Japanese semiconductor company. We also began beta testing a new digital telephone product for corporate PBXs which we developed with Noritel. Sales of CTI products to IBM also increased from 1995. However as stated in the first quarter of 1996, these shipments were not as high as originally expected.

We also announced a partnership with Northrop Grumman to develop new SHARCTM-based DSP products, which will be announced in 1997. Our new digital radio product line resulted in successful product introductions yielding, among other things, a \$2.5 million purchase order from the U.S. Department of Defense. This order contributed to our fourth quarter revenue growth of 2% over 1995. We expect continued strong growth for our digital radio products in 1997.

In May of 1996 we announced our intention to execute a secondary stock offering of \$10 million. This offering was not completed this due to disappointing market conditions in the small cap market. However, the offering was not completed despite improved financial performance and liquidity. I believe the market will be more receptive to our offering in the future.

I eagerly anticipate 1997 and our continued growth. I believe our products and services will continue to be successful and we will not be the leaders in our market. I believe we will continue to grow and we will continue to be successful in our market. I believe we will continue to be successful in our market.

Yours sincerely,

Barry

President, Spectrum

11/35/2006

SPECTRUM

annual report

company profile

Spectrum Signal Processing Inc. is the market leader in Digital Signal Processing (DSP) systems. The Company provides unique competitive advantages to its customers through its advanced technology, high quality products, and excellent customer service. Spectrum develops and manufactures products for every element of a DSP system from application software to turnkey systems for a wide range of markets. We provide turnkey DSP system solutions from project concept to system integration, testing and delivery. Our primary vertical markets include defense, OEM product development, motor control, and high-density modems. The Company has an outstanding track record in the DSP industry for providing quality products and services. We currently have a customer base of over 1000 customers and partners including IBM, Intel, Microsoft, PerkinElmer, Siemens and NEC. Spectrum has grown its revenue an average of 41% annually since 1992. It has 150 employees, with almost half the Company directly involved in engineering and development. Spectrum also supports over 100 manufacturers representing over 100 manufacturers around the world.

Spectrum is listed on the NASDAQ NMS under the symbol SSPIF and on the Toronto Stock Exchange under the symbol SSY. Spectrum can be found on the world wide web at: <http://www.spectrumsignal.com>.

financial highlights

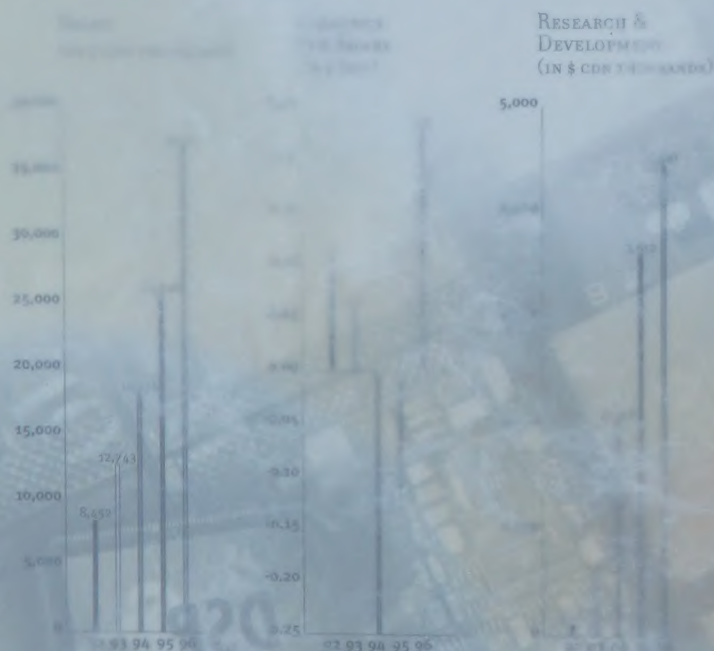


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Y E A R

letter to shareholders

Welcome to Spectrum's 1996 Annual Report. The theme this year is "time", a commodity which is precious to our customers who need to process information in billionths of a second. At the other end of the scale, 1997 marks Spectrum's tenth year in business and we are very proud of our significant accomplishments over this span of time, and in particular our achievements during 1996. In addition to 43% revenue growth, we were profitable throughout the year resulting in after-tax earnings of \$0.23 per share, up \$0.34 from a loss of \$0.11 in 1995. This financial performance far exceeds that of all other public competitors focused on the DSP systems market. Financial results alone do not tell the story, however, for there were many other milestones which the staff, management and shareholders can be proud of.

Research and development activity increased significantly during the year with expenditures increasing by 23% over 1995 levels. This substantial investment yielded several new products in 1996 and positions us well for many new product introductions in 1997. By the end of 1996, direct engineering staff approached 65, with another 10 in pre- and post- sales applications engineering.

Spectrum's superior DSP technology and high-quality manufacturing capabilities continued to attract Fortune 1000 product development partners and customers in 1996. For example, together with Hewlett-Packard we developed DSP products for VXI systems, which will be co-branded and sold by both companies. These products, consisting of DSP boards and software, are targeted at test and measurement, communications, industrial inspection, cellular base stations, diagnostic imaging, military, and aerospace applications which require significant signal processing horsepower.

Spectrum's Computer Telephony business also progressed during the year. Highlights include a development agreement for modem chipsets and DSP software with a major Japanese semiconductor company. We also began beta testing a new digital telephony product for corporate PBXs which we developed with Nortel. Sales of CTI products to IBM also increased from the previous year, however as stated in the first quarter of 1996, these shipments were not as high as originally expected.

Spectrum announced a partnership with Northrop Grumman to develop new SHARC™-based DSP products, which will be launched in 1997. Our new digital radio product line resulted in successful product introductions yielding, among other things, a \$4.5 million purchase order from the U.S. Department of Defense. This order contributed to our fourth quarter revenue growth of 72% over 1995. We expect continued strong growth for our digital radio products in 1997.

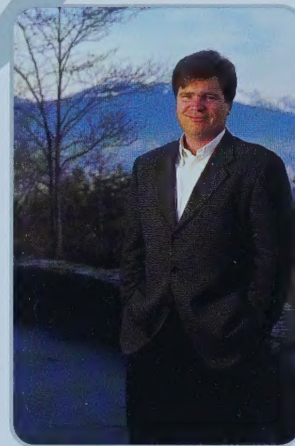
In May of 1996 we announced our intention to execute a secondary stock offering in the U.S. Unfortunately we were unable to complete this due to deteriorating market conditions in the small cap sector. This trend contributed to a share price decline despite improved financial performance, however, I believe the market will reward us in the future for consistent results.

I eagerly anticipate 1997 as Spectrum celebrates its tenth year in business. Looking back on these years I am extremely proud of our accomplishments and our high caliber team - the best in the industry. Without their tenacity, talent and dedication we would not be the leaders we are today. Together we will strive to achieve our primary goal to produce substantial returns for you, our shareholders. Thank you for your continued support.

Yours sincerely,



Barry Jinks
President & CEO



what is DSP? . . . the

A Digital Signal Processor (DSP) is a special processor which performs continuous mathematical computations on real-time signal information at a speed significantly faster than a regular microprocessor.

Digital Signal Processing (DSP) involves the conversion of analog signals, including light and sound, into a stream of digital values (ones and zeros) which are then processed, manipulated, exchanged, analyzed and stored by computing systems. DSP provides several advantages over traditional analog signal processing including: a higher degree of audio and video compression, greater storage and communication capacity, greater ability to process and manipulate data, enhanced product performance, the ability to process and adapt to changing signals in real-time, improved reliability over time, and easier development and upgrades for multi-functional products using programmable hardware and software.

From the introduction of mathematical equations to the announcement of the first computer, the mathematical theories behind Digital Signal Processing have been around for centuries. Spectrum has been a part of the DSP systems industry for ten years and will continue to pioneer the DSP systems solutions market.

the evolution

Digital filtering techniques used to solve astronomy problems and compile mathematical tables

1600's

Pierre-Simon Laplace discovered the attractive force of a mass due to a particle could be obtained directly by differentiating a single potential function. This laid the mathematical foundation for the analysis of heat, magnetism, and electricity. "Z-transform" is the mathematical basis of modern digital signal processing

1779

Jean Baptiste Fourier developed the Fourier Series, an expansion of period functions in terms of SINES and COSINES

1807

Development of mathematical tools - the most useful, a technique to evaluate the Fourier transform, a tool to measure frequency of a signal

1930's

Texas Instruments announced commercial production of silicon transistors

1954

inside story

analog

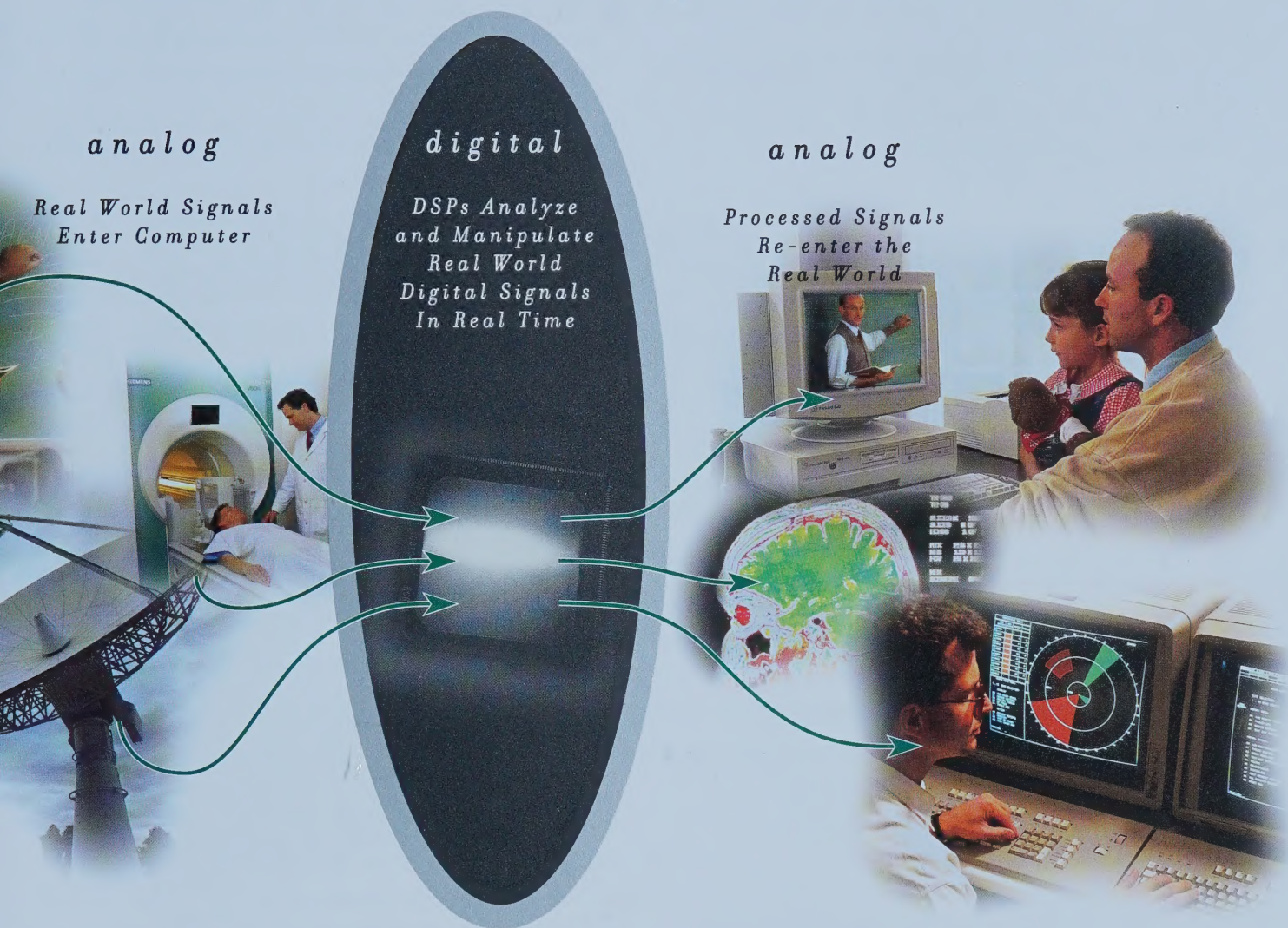
*Real World Signals
Enter Computer*

digital

*DSPs Analyze
and Manipulate
Real World
Digital Signals
In Real Time*

analog

*Processed Signals
Re-enter the
Real World*



o f D S P

Use of Z-transforms became public in the United States
Texas Instruments demonstrated the first integrated circuit

Digital Equipment Corporation invented the minicomputer
Practical real-time digital signal processing was initially
performed on DEC PDP- and VAX machines

Intel created the first 4004 microprocessor
Early DSP for military and medical performed on discrete
chips such as **Advanced Micro Devices** AM2901

American Microsystems Inc. announced the 12-bit S2811,
the first integrated circuit designed specifically for DSP
shipping

Texas Instruments "Speak and Spell" learning aid was
the first high-volume application of DSP

1958

1960's

1970's

1978

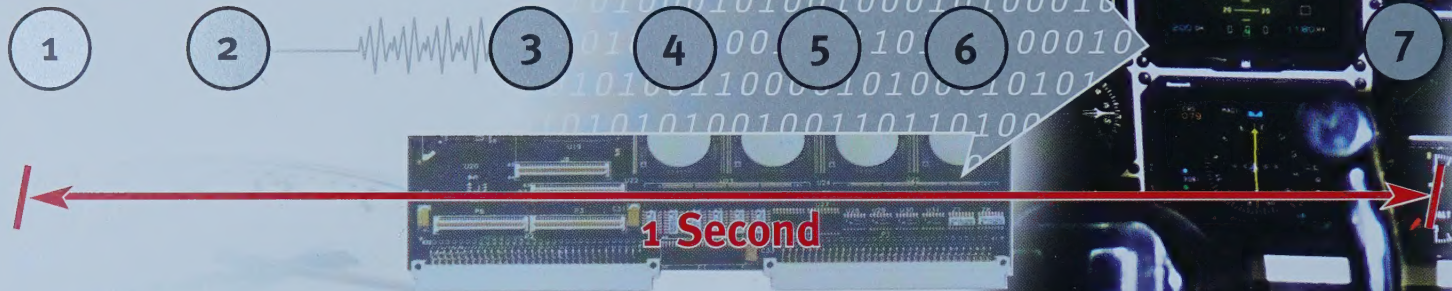


how fast is a DSP system?

In just one second a DSP chip can do millions of calculations on the incoming analog signals, such as sound, light or data.

The following is an example of what occurs in a radar-based aircraft landing system.

250 Million Calculations



- 1 Radar pulse emitted from aircraft
- 2 Radar reflects back from ground objects
- 3 Analog to Digital Conversion
- 4 Digital Filter
- 5 Radar Processing
- 6 Range Comparison
- 7 Output to aircraft's instrumentation

The DSP system processes the analog radar signal and compares it to digital images previously stored on a hard disk. This pinpoints the exact location of the aircraft.

the evolution

AT&T produced their first single-chip DSP the DSP-1, (for internal use only)

The first modern DSP chip was developed by NEC called the **MBD7720**

Texas Instruments introduced the **TMS32010** single-chip digital signal processor, the most successful DSP ever

Fujitsu launched the **MB8764**, a DSP chip that included improvements including serial communication ports and timers

Texas Instruments introduced the **TMS32020**, a joint design effort between TI and ITT Corp.

1979

1980

1982

1983

1985

Spectrum's DSP system solution

End User Application Software

Signal Processing Software

Real-Time DSP Operating Systems

Programmable DSP Chips from Various Vendors

ASICs

Boards

Systems

focused on the DSP systems market

Spectrum is the leader in the DSP system solutions business. The Company partners with DSP chip manufacturers, such as Texas Instruments and Analog Devices, to provide the DSP microprocessor layer, the only portion which is outsourced. Spectrum differentiates itself from competitors in the DSP systems market by providing all the other layers of a complete DSP system. This allows customers to rely on Spectrum for an integrated whole product solution eliminating the need to assemble the necessary parts from multiple vendors.

All of Spectrum's product solutions possess a very unique quality: they are all based on software programmable DSPs, rather than fixed-function DSPs. This allows maximum system flexibility and provides a better, more flexible system solution to its customers. By incorporating these high-end programmable processors into all its hardware products, the Company can offer customers the option to simply upgrade their old system rather than completely replacing it, often saving them a substantial amount of time and money.

Spectrum is a member of several key trade associations within the DSP industry. Involvement in these associations allows Spectrum to participate in defining new standards and to stay abreast of trends in the embedded systems market. This affiliation also allows the Company to provide leading-edge technology based on open industry standards and the latest DSP processors.

Spectrum is divided into two business units: MAC (Military, Aerospace and Commercial) and CT (Computer Telephony). The Company derives the majority of its revenue from the Military, Aerospace, Commercial business unit. Computer Telephony is an emerging opportunity for DSP companies and one on which Spectrum is capitalizing.

the evolution

Analog Devices announced the ADSP-21020 floating-point DSP chip
The first volume usage of DSP chips in production automobiles. DSP chips used to perform noise cancellation in the stereo systems of Nissans top of the line Infiniti™ auto.
Spectrum developed first custom ASIC (Application Specific Integrated Circuit)

Cadillac began shipping cars with DSP-based adaptive suspension
Spectrum's Mountain View, California office opened
Spectrum received Best Export Award

Texas Instruments provided an on-chip gate array capability
Spectrum was the first DSP company to enter into the CT Market
Spectrum breaks the \$10M mark in annual sales
Spectrum ships first VMEbus based products

1991

1992

1993





military, aerospace and commercial markets

Spectrum's MAC business unit receives the majority of its revenue from remote systems, support applications for the communications industry and real-time automation systems. In order to continue to exceed the growth rate of the industry, the Company has adopted a vertical market segmentation strategy.

Spectrum offers all its customers exclusive Commercial Off-the-Shelf plus (COTS+) product features including competitive price performance, fast time-to-market, modular industry standard product platforms, superior lifetime technical support and customer service, ISO 9001 quality certification for all products and a wealth of third party module and software options. These value added features provide Spectrum with an advantage over its competitors.

A sample of a few key applications in this segment incorporating DSP technology include: robotics, process control, diagnostic imaging equipment, wireless communications base and ground stations, radar, sonar, factory automation, satellite imaging, and avionics.



o f D S P

Spectrum received ISO 9000 quality certification
Spectrum was one of Canada's 100 Fastest Growing
 Companies honored by **PROFIT** magazine
Spectrum's Landover, Maryland; Dallas, Texas; and Iselin,
 New Jersey offices opened

A desktop audioconferencing system was introduced
 using Analog Devices' **ADSP-2181** DSP chip
Spectrum breaks the \$20M mark in annual sales

Office/IX Computer Telephony product won **Editor's Pick**
Award from Home Office Computing Magazine

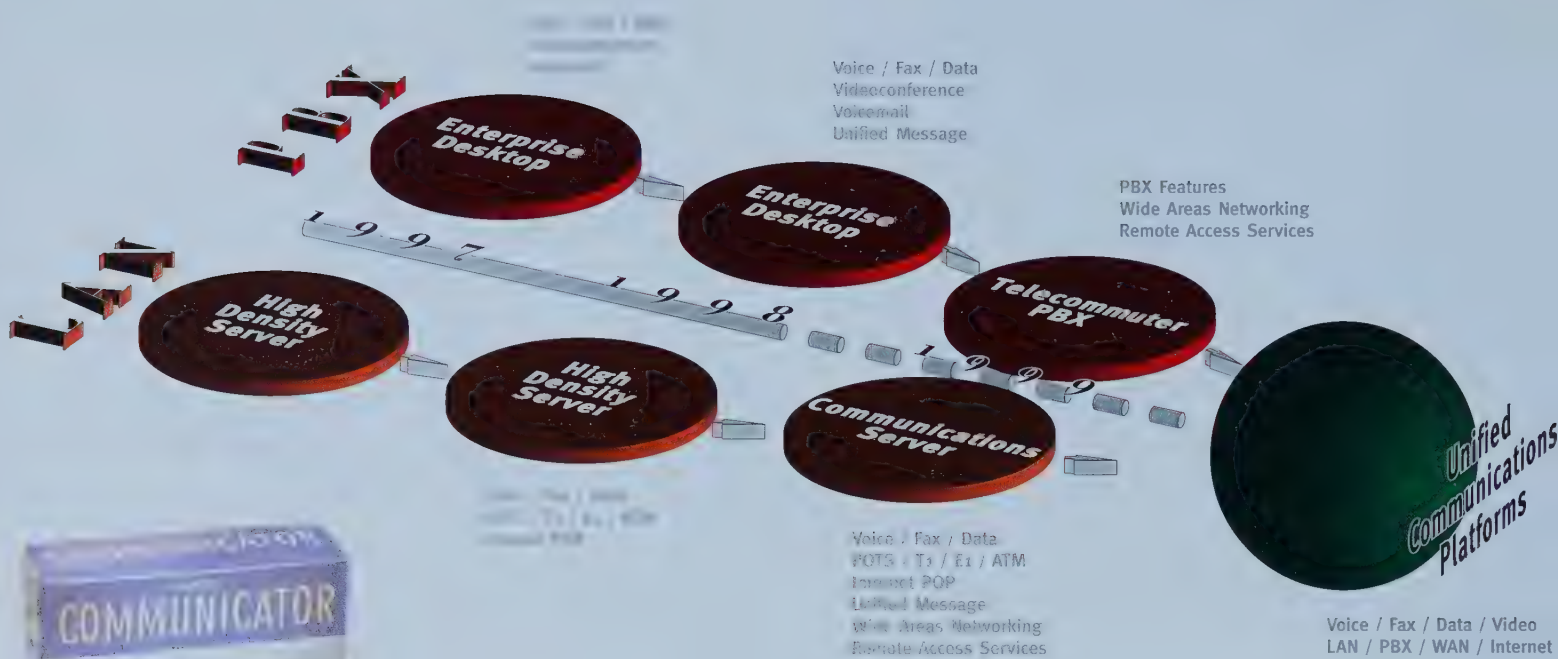
DSP moves into hearing aid market - DSP's coupled with
 A/D converters

Spectrum joins forces with **Hewlett-Packard** to design the
 first DSP-based VXI product suited to application such as
 test and measurement

The Company receives **Million Dollar Achievers Award** for
Outstanding Achievement in Business presented by
Business in Vancouver

Spectrum wins a **Best of Show Award** at the Computer
 Telephony Expo in Los Angeles

Spectrum partners with **Northrop Grumman** to design
 first SHARC-based DSP board



computer telephony

Computer Telephony involves integrating the intelligence of the computer with the power and versatility of telecommunications systems. The Company has developed strategic intellectual property to capitalize on new emerging market opportunities. Spectrum provides whole system solutions, including boards, software, and ASICs, allowing customers to bring unique CTI products to market.

Spectrum's skilled engineering team has developed computer telephony products for both analog communications and digital telephony. One such product involved a joint development project with Nortel. The two companies worked together to define and develop the "Communicator" PC card for digital PBX environments.

Spectrum is developing next generation CTI products for the enterprise desktop and CTI server markets, based on advanced processors such as Texas Instruments' C6x.



moving into 1997 in real-time...

The Company looks forward to 1997 as Spectrum celebrates its 10-year anniversary. Spectrum will capitalize on its tenth year as an opportunity to celebrate our leadership and increase Spectrum's worldwide profile through a new communications strategy. A new, innovative corporate identity has been developed for Spectrum's 10-year anniversary and will be promoted in all collateral and marketing programs during 1997.

As the leader in the DSP system solutions market, Spectrum strives to continually increase its market share year after year. The Company will focus on vertical markets that will provide the means to meet aggressive 1997 revenue targets and will concentrate on developing products for new emerging markets with high growth potential. Spectrum is the only supplier in the DSP industry with the vision, experience, desire and position to lead the consolidation of the DSP systems industry.

management's discussion and analysis**Overview**

The Company was founded in 1987 to manufacture and market products for the military/aerospace and commercial market in North America using DSP technologies licensed from Loughborough Sound Images Ltd. In 1993, the Company introduced its first CTI products for sale to OEMs and to consumers directly through retail distribution channels. In 1994, the Company developed a new release of its CTI product for high volume production targeted to leading OEM customers such as IBM and OMRON. In 1994, the Company recorded a charge against inventory relating to its first generation retail CTI product, and in 1995 the Company terminated its retail distribution efforts due to high marketing costs and a failure to achieve significant market penetration, which resulted in operating losses. Sales of CTI products accounted for 31.2% of sales in 1995 and 32.2% sales in 1996.

The Company devotes significant resources toward product development and related research and development activities. In recent years, the Company has sought to enter into agreements with its OEM customers and others under which the Company receives fees in connection with the development of products in anticipation of production ("development contract fees"), and uses these fees to fund such product development. The Company first derived revenues from development contract fees in 1994. Development contract fees are recognized as revenue upon the achievement of predetermined development milestones, which also typically coincide with invoicing and payments. See Note 1 of the Notes to the Company's financial statements. Costs associated with development contract fees are generally included in research and development expenses.

The timing and amount of development contract fees and the relative mix between products sold to the military/aerospace and commercial markets and those sold to the CTI market has affected and will continue to affect period-to-period comparisons of gross profit and income from operations. The Company's gross margins for the military/aerospace and commercial markets are typically higher than those in the CTI market due to low production volume and high proprietary technology content of the typical DSP solution for military/aerospace and commercial applications, as compared to the high production volume of the PC-based CTI applications.

Results of Operations

Sales in 1996 were \$36,914,000, an increase of \$11,168,000, or 43.4 % over sales in 1995. Approximately \$25,040,000, or 67.8% of 1996 sales consisted of DSP products for military/aerospace and commercial applications, compared to 1995 sales of comparable products of \$17,712,000, or 68.8% of sales. Approximately \$11,874,000, or 32.2% of 1996 sales consisted of sales of CTI products, compared to 1995 sales of comparable products of \$8,034,000, or 31.2% of sales. Included in 1996 sales were development contract fees of \$3,079,000, or 8.3% of sales, compared to development contract fees in 1995 of \$2,558,000, or 9.9% of sales. Development contract fees included fees associated with both military/aerospace and CTI projects, including fees generated in 1996 by the development of ASICs for a multimedia application in the Company's new ASICs and software market segment. The growth in the Company's sales in the CTI market was due principally to increased sales to IBM, the Company's largest customer.

Gross profit increased to \$17,992,000 for 1996 from \$11,695,000 for 1995, an increase of 53.8%. Gross margin (gross profit as a percentage of sales) increased to 48.7% in 1996 from 45.4% in 1995. The increase in gross margin was due primarily to the increase in development contract fees, which more than offset the effect of an increase in sales of CTI products.

Administrative, sales and marketing ("AS&M") expenses consist primarily of salaries, sales commissions and benefits related to the Company's sales, marketing and administrative personnel and independent sales agents. AS&M expenses for 1996, were \$10,321,000, or 28.0% of sales, compared to \$9,352,000 in 1995, or 36.3% of sales. AS&M expenses as a percentage of sales were significantly lower in 1996 compared to 1995 due to the increase in sales of CTI products in 1996 and the high level of expenses incurred by the Company in 1995 in anticipation of CTI product sales in future periods.

Amortization consists of the depreciation of the Company's fixed assets. Amortization expenses in 1996 were \$678,000, an increase of \$99,000, or 17.1%, over 1995. The increase in depreciation and amortization was due primarily to increased investment in fixed assets.

(continued)

management's discussion and analysis

Results of Operations *(continued)*

Research and development expenditures consist primarily of salaries, related personnel benefits, engineering service costs relating to development contract fees and direct overhead costs. Research and development expenditures were \$3,777,000 in 1996, or 10.2% of sales, compared to \$3,416,000 in 1995, or 13.3% of sales. The expenditures in 1996 consisted primarily of costs associated with development contract fees relating to ASICs and software and military/aerospace projects.

Other income for 1996 was \$39,000 compared to other income in 1995 of \$664,000, which consisted primarily of a gain arising from the sale of securities issued by QSound Labs, Inc. in connection with the formation of a 50/50 joint venture. See "-Liquidity and Capital Resources." The remainder of other income consisted primarily of interest income on short-term deposits.

Deferred income taxes for 1996 were \$1,074,000, which resulted from the drawing down of a portion of the deferred income taxes previously recorded. No income tax provision or recovery was recorded in 1995 due to the uncertainty that tax losses would be recoverable in the foreseeable future.

The Company had net earnings in 1996 of \$2,150,000 compared to a net loss of \$1,030,000 in 1995. Earnings per share in 1996 was \$0.23 per share, compared to a loss per share of \$0.11 per share in 1995.

Liquidity and Capital Resources

The Company has historically met its operating and capital requirements from cash flow from operations and funds generated by sale of its equity securities.

The Company has a credit facility with the Bank of Montreal (the "Bank"), consisting of a \$4,000,000 operating line of credit (the "Line of Credit"). Borrowings under the Line of Credit bear interest at the Bank's prime rate plus 3/4%, unless the borrowings are denominated in US dollars, in which case the rate of interest is the Bank's US dollar rate plus 3/4%. Borrowings are due on demand and interest is to be paid monthly. Borrowings may not exceed certain percentages of a specified borrowing base consisting of domestic and foreign accounts receivable. The Line of Credit agreement requires the Company to maintain certain financial ratios and a positive cash flow, restricts the payment of dividends and limits capital expenditures to available cash flow. Borrowings under the Line of Credit are secured by substantially all of the Company's assets. As of the date of this report, the Company does not have any outstanding borrowings under the Line of Credit.

At December 31, 1995 and December 31, 1996, the Company's cash position was \$1,922,000 and \$2,038,000, respectively. Net cash provided by (used in) operations, financing and investments was \$937,000 and \$116,000 in 1995 and 1996, respectively. For 1996, cash provided by operations, financing and investments consisted primarily of cash from operations and proceeds from the issuance of common shares upon the exercise of options, which was offset by cash used primarily to reduce accounts payable and for the purchase of fixed assets and software and related development costs. The increase in cash provided by operation, financing and investments in 1995 was due principally to Company's receipt of funds upon the exercise of outstanding stock options and proceeds from the disposal of securities of QSound Labs, Inc. offset in part by the Company's operating loss.

Accounts receivable, net at December 31, 1995 and 1996 was \$6,675,000 and \$11,493,000, respectively. The Company's standard collection terms are net 30 days, subject to adjustment for certain customers.

The Company made capital expenditures of \$1,105,000 during the year ended December 31, 1995 and \$2,085,000 during the year ended December 31, 1996, primarily for computer equipment and software and related development costs.

The Company believes that cash generated from operations and borrowings available under the Line of Credit agreement, will be sufficient to meet its foreseeable working capital and capital expenditure requirements. However, the Company may in the future require additional equity or debt financing to meet its working capital and fixed asset requirements. There can be no assurance that additional financing will not be required sooner or, if required, that it will be available on a timely basis or on terms satisfactory to the Company.

management's discussion and analysis

Outlook

Management expects similar sales growth in 1997 in its business to that which it experienced in 1996 based upon its current product offering and new products stemming from its hardware, ASIC and DSP systems capabilities.

Risk Factors

Although the market for the Company's products appears to be expanding, its ability to remain competitive is dependent upon assessing changing markets and providing new products and capabilities. There can be no assurances that the Company will be able to develop or license new products to meet changes in the marketplace or that the sale of such new products will be profitable. Certain of the Company's competitors have greater financial resources than the Company and may be able to sustain recurring losses to establish a market share at the Company's expense.

The Computer Telephony market is very price sensitive and the Company's success in this business is dependent upon its ability to generate volumes sufficient to allow it to achieve production economies of scale.

The Company believes that inflation and other changes in prices have not had a material effect on the Company. The Company intends to continue to sell the majority of its products in US dollars while incurring costs in varying proportions in Canadian dollars, US dollars and other currencies. Thus, the Company's operations are susceptible to fluctuations in currency exchange rates. In addition, if the Canadian dollar rises relative to the US dollar, the Company's reported Canadian dollar sales and net income may be materially and adversely affected. While the Company does attempt to mitigate some of the risks of exchange rate fluctuations between the US dollar and Canadian dollar by denominating many of its payment obligations in US dollars and, to a lesser extent, through the use of exchange-traded or over-the-counter contracts, there can be no assurance that these strategies will substantially reduce the potential adverse effect of exchange rate fluctuations on the Company's business, financial condition or results of operations.

auditors' report to shareholders

We have audited the balance sheets of Spectrum Signal Processing Inc. as at December 31st, 1996 and 1995 and the statements of operations and retained earnings (deficit) and changes in financial position for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principals used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at December 31, 1996 and 1995 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principals. As required by the Company Act of British Columbia, we report that, in our opinion, these principals have been applied on a consistent basis.

KPMG

Chartered Accountants
Richmond, Canada
February 12, 1997

balance sheets

(Expressed in thousands of dollars)

	1996	1995
ASSETS		
	\$ 2,038	\$ 1,922
	11,493	6,675
	2,396	3,150
	707	385
	16,634	12,132
	2,920	2,177
	-	1,019
	1,124	197
	\$ 20,678	\$ 15,525

LIABILITIES & SHAREHOLDERS' EQUITY

	6,916	4,425
	13	39
	6,929	4,464
	55	-
	-	13
	13,368	12,872
	106	106
	220	(1,930)
	13,694	11,048
	\$ 20,678	\$ 15,525

On behalf of the Board



Barry Jinks
President & CEO



Samuel Znaimer
Director

statements of operations and retained earnings (deficit)

(Expressed in thousands of dollars, except per share amount)

Years ended December 31,	1996
Sales	\$ 36,914
Cost of sales	18,922
	17,992
Expenses	
Administrative	4,158
Sales and marketing	6,163
Amortization	678
Research and development	3,777
	14,776
Earnings (loss) from operations	3,216
Other revenue (expense)	
Interest and bank charges	(31)
Other income	39
	8
Earnings (loss) before income taxes	3,224
Deferred income taxes (benefit)	1,074
Net earnings (loss)	\$ 2,150
Deficit, beginning of year	(1,930)
Retained Earnings (deficit), end of year	\$ 220
Earnings (loss) per share (basic)	\$ 0.23

See accompanying notes to financial statements

statements of changes in financial position

(Expressed in thousands of dollars)

	1996	1995
Cash provided by (used in)		
	\$ 2,150	\$ (1,030)
	678	579
	1,074	-
Marketable securities	-	(540)
Operating working capital	(1,895)	(1,047)
	2,007	(2,038)
	(263)	-
Expenses	496	942
	(39)	(144)
	194	798
	(1,421)	(909)
Costs	(664)	(196)
Liabilities	-	1,925
	-	1,357
	(2,085)	2,177
	116	937
	1,922	985
	\$ 2,038	\$ 1,922

notes to financial statements

Year Ended December 31, 1996 (Tabular amounts expressed in thousands of dollars, except per share amounts and numbers of shares)

The Company was incorporated under the laws of British Columbia and its principal business activities include the design, manufacture and marketing of digital signal processing systems for incorporation into high-performance applications for original equipment manufacturers for computer telephony integration, multimedia, military, aerospace and commercial markets.

1. SIGNIFICANT ACCOUNTING ESTIMATES

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, particularly the recoverability of capital and other assets, and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from the estimates.

Cash and short term deposits

Cash includes short-term deposits, which are all highly marketable securities with a maturity of three months or less. Short-term deposits are valued at cost.

Inventories

The Company uses the average cost method of accounting for its inventory. Inventories are valued at the lower of cost and net realizable value and consist of:

	1996
Finished Goods	\$ 1,011
Raw Materials	1,385
Work in progress	-
	\$ 2,396

Research and development costs

Research costs are expensed as incurred. Development costs are expensed as incurred unless they meet certain criteria under generally accepted accounting principles for deferral and amortization. Software and related development costs, after the establishment of technological feasibility and commercial viability, are capitalized until the product is available for general release to customers. Amortization is provided on a product by product basis over the estimated economic life of the software, not to exceed three years. Amortization commences when the product is available for general release to customers.

Capital assets

Capital assets are initially recorded at cost. Amortization is subsequently provided on the following assets using the declining balance basis at the following annual rates:

Computer equipment	30%
Computer software	20%
Furniture and fixtures	20%
Laboratory equipment	20%

Amortization of leasehold improvements is provided on a straight-line basis over the lesser of their estimated useful lives or five years.

License

The Company has the exclusive North American license to manufacture and distribute computer peripherals for digital signal processing systems designed by Loughborough Sound Images Ltd. The license has been recorded at a nominal value of \$1 and expires in July 1997. The Company recently negotiated a non-exclusive extension of manufacturing rights to 2002 and distribution rights to January 17, 1999. Both the manufacturing and distribution rights may be extended.

Translation of foreign currencies

All monetary assets and liabilities denominated in foreign currency have been translated into Canadian dollars at the rate of exchange in effect at the balance sheet date. Other assets, revenue and expense items are translated at the rates prevailing at their respective transaction dates. Gains and losses resulting from foreign exchange translation are reflected in earnings for the year.

notes to financial statements (continued)

Revenue recognition

Military/aerospace and commercial product revenue is recognized upon shipment. Computer telephony integration ("CTI") product revenue is recognized upon the later of shipment or transfer of title. Revenue from product development contracts is recognized upon reaching certain development milestones which are generally correlated to the timing of payments. The Company generally allows its retail distributors to exchange unsold products for other products and provides inventory price protection in the event of reductions by the Company. Accordingly, allowances for sales returns and price protection are recorded at the time sales are recognized.

Warranty

The Company generally provides a one year warranty to the original purchaser. Warranty costs are accrued based on a best estimate, with reference to past experience.

Income taxes

The Company follows the allocation method for accounting for income taxes. Under this method, recognition is given in the financial statements to the tax effects of timing differences between income and expenditures for financial statement and income tax purposes. As at December 31, 1995, the timing differences arose primarily from recording the expected income tax benefits of share issue costs, research and development expenditures and investment tax credits in the year the costs were incurred or the credits earned, which is in advance of the period in which they are recognized for tax purposes. The Company substantially realized these benefits in 1996.

The Company follows the cost reduction method of accounting for investment tax credits whereby the benefit of tax credits is recognized as a reduction in the cost of the related asset or expenditure when there is reasonable assurance the tax credits will be realized.

Share issue costs

The costs of issuing common shares, net of income tax recoveries thereon, are applied to reduce the stated value of such shares.

Deferred share issue costs

The majority of the costs incurred in the form F-1 registration and preliminary prospectus process have been expensed, the balance have been deferred and will be charged to shareholders' equity upon the issuance of the related shares or will be charged to operations upon the abandonment of the process.

Fair value of financial instruments

Carrying amounts of certain of the Company's financial instruments, including cash, short-term deposits, accounts receivable and accounts payable and accrued liabilities approximate fair value due to their short maturities. Based on borrowing rates currently available to the Company for loans with similar terms, the carrying value of its long-term debt approximates fair value.

Concentration of credit risk

Financial instruments that potentially subject the Company to concentrations of credit risk are primarily cash, term deposits and accounts receivable. Credit risk in receivables is limited to original equipment manufacturers and to dealers and distributors of hardware and software products to the retail market.

The Company adopts credit policies and standards to monitor the evolving software industry. Management is of the opinion that any risk of accounting loss is significantly reduced due to the financial strength of the Company's major customers. The Company performs on-going credit evaluations of its customers' financial condition and requires letters of credit or other guarantees whenever deemed necessary.

Substantially, all of the Company's revenues have been recognized in currencies other than the Canadian dollar, principally the United States dollar. Fluctuations in the exchange rates between these currencies and the Canadian dollar could have a material effect on the Company's business, financial condition and results of operations. The Company attempts to mitigate some of this risk by denominating many of its payment obligations in United States dollars, and, to a lesser extent, through the use of forward exchange contracts.

Technological risks

The market for the Company's products is characterized by rapidly changing technologies, evolving industry standards and frequent new product introductions and enhancements. There can be no assurance that the Company will successfully develop, complete, introduce, and market new products or product enhancements, or that the products or product enhancements currently in development or that may be developed by the Company in the future will meet industry requirements and achieve market acceptance. Any significant delay or failure to develop, manufacture or ship new or enhanced products could have a material adverse effect on the Company's business, financial condition and results of operation.

Joint venture

The Company follows the proportionate consolidation method for accounting for its investment in a joint venture. In the year the Company recognized \$nil (1995-\$67,000) in revenue and \$nil (1995-\$269,000) of development expenses as its proportionate share. At year end there were no additional liabilities arising from the joint venture.

notes to financial statements (continued)

Year Ended December 31, 1996 (Tabular amounts expressed in thousands of dollars, except per share amounts and numbers of shares)

Joint Venture (continued)

The following amounts relate to the Company's proportionate share in the Joint Venture and are included in the Company's accounts:

	1996
Balance Sheets	
Current assets	-
Statements of Operations	
Sales	-
Costs and expenses	-
Loss from continuing operations and Net Loss	-
Statements of Changes in Financial Position	
Cash provided by (used in) Operations	
Net loss	-
Accounts receivable	67
Increase (Decrease) in cash	\$ 67
Comparative figures	
Certain comparative figures have been	

2. CAPITAL ASSETS

	1996
Computer equipment	\$ 2,432
Computer software	1,020
Furniture and fixtures	837
Laboratory equipment	469
Leasehold improvements	349
	\$ 5,107
Accumulated amortization	(2,187)
Net book value	\$ 2,920

notes to financial statements (continued)

Year Ended December 31, 1996 (Tabular amounts expressed in thousands of dollars, except per share amounts and numbers of shares)

	1996	1995
	\$ 263	\$ -
	860	196
	1	1
	\$1,124	\$ 197

	1996	1995
%	\$ 13	\$ 52
	(13)	(39)
	\$ 0	\$ 13

000.000 common shares with no par value

	Number of Shares	Stated Values
	8,899,902	\$ 11,968
	264,072	942
	9,163,974	12,910
	79,709	496
	9,243,683	\$ 13,406
	1996	1995
	\$ 13,406	\$ 12,910
	(38)	(38)
	\$ 13,368	\$ 12,872

notes to financial statements (continued)

Year Ended December 31, 1996 (Tabular amounts expressed in thousands of dollars, except per share amounts and numbers of shares)

(c) Stock option plan

The Company has reserved 2,000,000 common shares for issuance under its stock option plan. The plan provides for the granting of stock options to directors, officers and eligible employees at the fair market value of the Company's stock at the grant date. Options generally vest over three years in equal amounts at the end of each year of the grant. Options generally have a five year term with ten years being the maximum.

Stock option activity for 1995 and 1996 is presented below:

	Number of Shares	Exercise price per share
Outstanding, December 31, 1994	1,322,650	
Granted	194,000	\$6.38 - \$17.00
Exercised	(264,072)	\$0.70 - \$ 7.00
Cancelled	(35,932)	\$6.00 - \$ 6.25
Outstanding, December 31, 1995	1,216,646	\$0.70 - \$17.00
Granted	416,756	\$8.00 - \$17.00
Exercised	(79,709)	\$2.14 - \$ 9.00
Cancelled	(50,597)	\$4.80 - \$17.00
Outstanding, December 31, 1996	1,493,896	\$0.70 - \$16.10
Exercisable at:		
December 31, 1995	783,846	
December 31, 1996	731,898	

The options outstanding at December 31, 1996 expire between November 1, 1997 and January 1, 2004.

(d) Contributed surplus

During 1994, the Company purchased and sold 248,000 of its common shares at prices in excess of cost of \$12.

6. INCOME TAXES

Income tax expense varies from the amounts that would be computed by applying Canadian federal and provincial income tax rates of 45.6% (1995-45.6%) to earnings (loss) before income taxes as follows in the following table:

	1996	1995
Combined Canadian federal and provincial income taxes at expected rate	1,493	\$ (1,493)
Permanent and other differences	5	
Recoveries not tax effected	-	40
Reduction of income taxes from use of unrecorded tax benefits	(424)	
	\$ 1,074	\$ (1,453)

As at December 31, 1996 the Company has investment tax credits of approximately \$1,400,000 available to reduce future years' income taxes payable. These investment tax credits expire between 2003 and 2006. In addition, research and development expenditures (net of the above investment tax credits) of approximately \$100,000 are available to reduce taxable income in future years. These amounts can be carried forward indefinitely. The potential tax benefits that may arise from the utilization of these amounts have not been recognized in these financial statements.

notes to financial statements (continued)

Year Ended December 31, 1996 (Tabular amounts expressed in thousands of dollars, except per share amounts and numbers of shares)

Weighted average number of shares outstanding

Weighted average number of shares outstanding during the year, which was 9,194,558

Lease agreements with remaining terms of up to five years, for office premises and the next five years are approximately as follows:

1997	\$ 577
1998	546
1999	516
2000	509
2001	503

\$ 2,651

industry segment, being the design, manufacture and marketing of dig- and operations are in Canada. A summary of sales by region and by major cus-

1996	1995
\$ 30,951	\$ 20,904
5,963	4,842
\$ 36,914	\$ 25,746
\$ 8,689	\$ 4,241
8,569	2,615

Head Office

8525 Baxter Place
100 Production Court
Burnaby, BC V5A 4V7
Tel (604) 421-5422

Branch Sales Offices

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Tel (604) 421-5422

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Registered Office

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Transfer Agent & Registrar

Montreal Trust Company of Canada
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Richmond, BC V6V 1C6

Bankers

Bank of Montreal
First Bank Tower
595 Burrard Street
Vancouver, BC V7X 1L5

General Legal Counsel

Clark Wilson
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Vancouver, BC V6C 3H1

Investor Relations

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Burnaby, BC V5A 4V7
Tel (604) 421-5422
Fax (604) 421-1764

Shares Listed

NASDAQ NMS - SSPIF
Toronto Stock Exchange - SSY

Annual General Meeting

The annual general meeting of shareholders will be at 1:30 PM
Wednesday June 11th, 1997 at:

The Waterfront Hotel
900 Canada Place Way
Vancouver, B.C.
V6C 3L5

notes to financial statements

Year Ended December 31, 1996 (Tabular amounts expressed in dollars, except per share amounts and numbers of shares)

7. EARNINGS (LOSS) PER SHARE

Earnings (loss) per share is calculated by dividing net income (loss) available to common shareholders by the number of shares outstanding during the year, which was 9,194,558 shares.

8. LEASES

The Company has entered into several lease agreements with remaining terms of up to five years, for office premises and equipment. The aggregate lease payments for the next five years are approximately as follows:

	1997	\$ 577
	1998	546
	1999	516
	2000	509
	2001	503
		\$ 2,651

9. SEGMENT INFORMATION

The Company has one reportable segment, being the design, manufacture and marketing of digital products. The Company's operations are in Canada. A summary of sales by region and by major customer is as follows:

	1996	1995
Sales	\$ 30,951	\$ 20,904
Operating expenses	5,963	4,844
Operating income	\$ 36,914	\$ 25,746
Interest expense	\$ 8,689	\$ 4,344
Income before income taxes	8,569	2,615

Board Of Directors

Michael Mertens
Chairman
Spectrum Signal Processing Inc.

Barry Jinks
President & CEO
Spectrum Signal Processing Inc.

Joseph Abrams
Corporate Director

Dr. Karl Brackhaus
President & CEO
Dynapro Systems Inc.

John E. Brennan
President
Activated Communications Inc.

Charles C. Johnston
President & Director
J & C Resources Inc.

Sam Znaimer
Vice President
Ventures West Technologies Inc.

Corporate Officers

Barry Jinks
President & CEO

David Hobbs
Vice President, Engineering

Doug Johnson
Vice President, Logistics

Brian Lowe
Vice President, Sales

Martin McConnell
Vice President, Finance,
CFO & Secretary

Ron Wages
Vice President, Marketing

Head Office

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01581 - 3938
Tel (508) 366-7355

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Tel (301) 918-2522

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Registrar**

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